'Mother Nature is slapping us in the face,' CalSTRS' Ailman says

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Body

Amid political backlash and rising interest rates, ESG exchange-traded funds and mutual funds have stopped seeing inflows. Some U.S. red states have enacted or sought to pass laws outlawing ESG considerations in investments, while large asset managers have pulled out of climate-focused initiatives.

But at the California State Teachers' Retirement System, sustainability is integrated "in everything, in every way, in every minute of every day," said Christopher Ailman, CIO of the $331.4 billion West Sacramento-based pension fund.

Despite the anti-ESG backlash unfolding across the U.S., CalSTRS is "still marching ahead because the environment isn't changing," he said at an April 16 panel held at the BloombergNEF Summit in New York.

A proponent of investing in the energy transition, Ailman will retire June 30 from the nation's second-largest public pension fund, where he has worked since 2000. He will continue to serve as an adviser through the end of 2024.

Ailman has said he will continue to press investors to factor in the risks of climate change into their investment decisions. For now, he's emphasizing that sustainable investing is "all about long-term thinking," which is important at CalSTRS, given it provides plan participants money for up to "potentially 60 years."

"I always like to share we have over 450 teachers that are retired on our payroll that are over 100 years old - they live a long time," Ailman said.

"It is such a challenge, so we think long term, and when we think long term, we take into account all these kinds of risks," Ailman added. "We have been saying loud and clear that this energy transition is a massive wave coming - both an opportunity and a risk - and it's something to pay attention to. The board is already improving us to adjust the portfolio in anticipation of it."

Better despite pushback

Despite pushback from state legislators, the BloombergNEF panelists acknowledged that there have been improvements in terms of getting the U.S. to advance in the climate transition.

For Steven Rothstein, founding managing director at the Ceres Accelerator for Sustainable Capital Markets, this is "kind of the best of times, the worst of times, in the sense of if you just take a broad view a few years ago, there was not a single major institutional investor that had a net-zero plan."

While the Securities and Exchange Commission did not go as far as his nonprofit organization had wanted it to on the climate disclosure rule it finalized on March 6, he said "what they've done is a good first step" in setting "very strong legal ground." The enactment of California's Climate Corporate Data Accountability Act is also a promising move going forward as it requires public and private companies doing business with the state to submit data, he added.

"What we're finding is many people, companies (and) investors are continuing to do what they were doing," Rothstein said. "They may not be talking about it. They may not be holding as many press conferences to talk about it because of pushback, but we're seeing growth opportunities."

Ailman noted that "2030 is barely six years from now" and is "going to be upon us," so the challenges imposed by the natural world will "become a bigger conversation."

"Mother Nature right now is slapping us in the face," Ailman said. "I could be wrong, but I bet within about four years, it's going to be punching us in the face."

Calling for more transparency on what companies are doing to address climate risks and opportunities "at an increasing rate," Ailman told investors "you've got to focus on educating yourself and focusing it on your strategy."

Ailman has said he hopes investment terminology expands to "get away from simple initials" such as ESG - environmental, social and governance. From what he's seen in polling, Ceres' Rothstein said "75% of people have no idea what the acronym 'ESG' means."

"But if you ask them about the underlying elements, there's overwhelming support, meaning 'do you think a company should be profitable and care about the community (and) care about water?'" Rothstein said. Among Democrats and Republicans, he noted support is "over 90%, so the key thing is defining what you mean."

Various companies have defined for themselves sustainable investing terms such as "energy transition," noted Valerie Smith, managing director and chief sustainability officer at Citigroup Inc. The global bank does business in 160 countries, and she said "many of our governmental clients and regulators have definitions" for the term.

"I don't know that you can say there's going to be one definition for the word," Smith said. "It's a business decision, but it's important to be transparent about that business decision so your regulators, your investors (and) your clients understand your point of view - and it could be a commercial advantage. If you figure this out, and you're able to help your clients more efficiently because of it, that's a transition finance opportunity, right?"

While she noted that ESG-labeled products have faced headwinds, Smith said they are "still quite resilient" and she doesn't think activities will go away among Citi's clients based on how the bank is engaging with them.

Seeking longevity

In its portfolio, CalSTRS seeks "companies that will survive over 200 years," Ailman said. If a company says it will make and abide by its own sustainable goals, he's "going to want to hold (them) accountable" so they follow through.

"I really like the idea of a transition because we see transition plans from people," he said. "But I was like, 'Okay now, enough words. Let's see. Put up and show us what you're actually doing about contraceptive planning."

CalSTRS has invested in certain energy sectors such as the oil industry in an attempt to "turn things around," Ailman said. The pension fund has been active with a "really tiny hedge fund" to change the board at ExxonMobil.

On investing in gasoline providers, "you start to hear them talk about being a chemical company or a molecule company, you hear different things," which Ailman said is "not necessarily fast enough for us to be happy, but at least they're changing."

"If anybody's going to spend money on new technologies, we can't wait for the federal government," he added. "We need the U.S. oil industry to lead that charge because Saudi Arabia is not going to do so."

In an analogy, the CIO shared that his doctor told him to lose weight, and he ignored it. "Apparently, that didn't work, so ignoring things doesn't make it change. You have to do something," he said.

As part of Citi's sustainability function for 20 years and watching companies make statements about commitments to sustainability, Smith said corporations "need to resist the instinct to lead with aspiration" in their communications and marketing "because it almost distracts from the key message."

"There's been a little bit of recalibration and less of an emphasis on shouting from the rooftops about your sustainability attributes and more of a focus on the real - and the fact that you're an investor, you probably want more data and not less data," Smith said.

Three years from now, Ceres' Rothstein thinks investors will be talking more about what companies' data actually shows. But while Rothstein and Smith note investors will want more data, CalSTRS' Ailman cautioned that investors need to consider how much data they're receiving and how it's being assessed.

With the internet, the CIO said he finds "students get too much information," and they have to judge "what's garbage and what's useful." It's almost "the same problem with my credit team, and my analysts get too much information. They have to discern what's useful," he added.

Additionally, Ailman said it's not helpful to compare two things "having different time periods, different metrics and just all that uncertainty about whether it's audited." He also noted investors will have to reconcile with the existence of different disclosure systems across continents, saying that the lack of consistent data is a "nightmare."

"When you travel, isn't it fun to take all kinds of little plugs that are all shaped different ways to get them to go on a different wall? It's all electricity ... but the point is uniformity makes life so much simpler, so if we as an investor could have consistent, uniform data on this kind of disclosure around the world," he said.

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